



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE  
1100 Commerce, MC 4920 DAL  
Dallas, TX 75242

501.07-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

November 24, 2010

Release Number: 201107030

Release Date: 2/18/11

LEGEND

ORG - Organization name

XX = Date Address = address

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear

In a determination letter dated January 19XX, you were held to be exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On June 22, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal

Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
1616 Capitol St Ste 450 Stop 4710OMA  
Omaha, NE 68102-4923

June 15, 2010

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free \_\_\_\_\_ and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018  
Report of Examination  
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer		Year/Period Ended
ORG EIN: EIN		20XX/12

**LEGEND**

ORG = Organization name      XX = Date      City = city      State = state

**Issue:**

Whether ORG qualifies for exemption under Section 501(c)(7) of the Internal Revenue Code?

**Facts:**

Articles

The articles were filed 7-27-19XX. The articles stated the purpose was to manage and control without profit to the stockholders, for social and charitable purposes a golf course in City, State. There was not a discriminatory statement to violate their exempt status.

Activities

The club is bound together for the common purpose of golfing. The Club manager operates the bar and restaurant. During the 20XX period, they remodeled the bar and increased the business for the rental facility. The club's income is from membership dues, hall rental, green fees, cart and shed rental and cart lease rental. The membership consists of family, single, social, couples and students.

The Club House is open from April to Oct from 9:00AM to 5:30PM Sunday to Saturday. The course is open from approximately 7AM to Sunset 5-5:30PM. The hours are flexible according to the weather, sunrise and sunset. Tuesdays and Wednesdays are league days. They may have 3-4 tournaments per year. There are invoices recorded for all golfing, rentals and bar/food sales. The Taxpayer did follow Rev. Proc. 71-17, 1971-1 C.B. 683.

The Power of Attorney (POA) advised me how to distinguish between member, non-member income and combined member and non-member income categories. The green fees and cart rental was non-member income only; cart lease and shed rental is member only income. For the 12/31/20XX tax period, I recorded the actual member and non-member income from the event invoices. I totaled all the identified combined member/non-member income from the invoices. The POA informed me since forever a historical 33% was used to determine the non-member income. The formula used to categorize member/non-member is: I identified the combined mem/non-member income, then subtracted the actual member and non-member income=remainder income (if any) is then multiplied by the 33% historical figure used by the POA. I tried to compute a more reasonable percentage by taking all the percentage's derived from the various non-member/total incomes but the average totaled 54% and did not seem appropriate for the daily traffic, so I used the 33% historical figure. Using the 33% non-member income figure is more than 15% gross receipts test and will result in an inevitable amount of being over the 15% gross receipts test.

The profit and loss statements were used to compute the 12/31/20XX and the 12/31/20XX unrelated business income (UBI) gross receipts test. The Form 990 for the 12/31/20XX period was used to determine the UBI gross receipts test. The percentage for the UBI gross receipts test for 20XX to 20XX are as follows: 31%, 36% and 40% worksheets attached. Because the unrelated business income (UBI) gross receipts is over

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
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Name of Taxpayer		Year/Period Ended
ORG EIN: EIN		20XX/12

the 15% for non-member income for three years, revocation was recommend effective January 1, 20XX.

**Law:**

**IRC § 501(c)(7)** Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

**REGS, §1.501(c)(7)-1. Social clubs** (a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption. [Reg. §1.501(c)(7)-1.]

**IRC § 277. DEDUCTIONS INCURRED BY CERTAIN MEMBERSHIP ORGANIZATIONS IN TRANSACTIONS WITH MEMBERS.**

**IRC § 277(a) GENERAL RULE.** —In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. The deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year.

**Revenue Procedure 71-17, 1971-1 C.B. 683**, describes the record-keeping requirements for social clubs exempt under IRC 501(c)(7) with respect to nonmember use of their facilities; it sets forth guidelines for determining the effect of gross receipts derived from public use of the club's facilities on exemption and liability for unrelated business income tax.



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### Gross Receipts Test / Public Law 94-568

Section 501(c)(7) was amended in 1976 by Public Law 94-568 to provide that section 501(c)(7) organizations could receive some outside income without losing their exempt status. Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, explains that a social club is permitted to receive up to 35 percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. It is also intended that within this 35 percent amount not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public (nonmembers). In effect, the latter modification increases from 5 percent (Rev. Proc. 71-17, 1971-1 C.B. 683) to 15 percent the proportion of gross receipts a club may receive from making its club facilities available to the general public without losing its tax exempt status.

The Senate Report also states that it is not intended that these organizations should be permitted to receive, within the 15 percent or 35 percent allowances, income from the active conduct of businesses not traditionally carried on by these organizations. In cases where an organization's nontraditional income would cause the organization to exceed the 15 or 35 percent allowances, consideration should be given as to whether the organization continues to be substantially operated for IRC § 501(c)(7) purposes.

According to the Committee Reports, where a club receives income from other sources (non-traditional or unusual), including income from the sale of its clubhouse or similar facility, that income is not to be included in the formula; that is, such income is not to be included in either the numerator or the denominator for purposes of computing the 35 or 15 percent allowances.

The Committee Reports provide that **gross receipts** include, charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts), and *normal recurring capital gains on investments*, **but excluding initiation fees and capital contributions**.

Where college fraternities or sororities charge membership initiation fees but not normal dues, such fees will be included in their gross receipts, notwithstanding that initiation fees are ordinarily excluded (Senate Report 94-1318, 2d Session, 1976-2 C.B. 599.).

### Taxpayer's Position:

Discussed the issue with the POA and the Taxpayer and they agreed the non-member income exceeded the gross receipts limitations. POA has been compliant and sent in converted Forms 1120 for the December 31, 20XX, 20XX and 20XX tax periods.

### Government's Position:

Based on the facts of the examination, the organization does not qualify for exemption since the operations were more than substantial for non-members. The Public Law 94-568 and Senate Report No. 1318 amended IRC 501(c)(7) as of October 20, 19XX. Those



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ORG EIN: EIN		20XX/12

documents limited the non-member income to be received by social clubs. This organization substantially exceeded the 15% limitation from non-member income for three consecutive years.

**Conclusion:** Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(7) and its tax exempt status should be revoked. Accordingly, the organization's exempt status is revoked effective January 1, 20XX.

Per Section 277 of the Internal Revenue Code (Code), a non-exempt organization that is a membership organization is allowed a deduction for expenses that relate to the operation of the organization for its members. Section 277(a) states that "In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members, and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members)".

When completing the Form 1120 the organization must divide the income and expenses between the member and non-member activities. If there is a loss from the membership activity it cannot be used to offset the income from the non-member activities. A loss on the member activity can be carried forward to a later year to be taken against member income.

Form 1120 returns should be filed for the tax periods ending on or after December 31, 20XX.